private operators. However, the industry filings do support the contention that in calculating "competitive rates," i.e., rates that would exist if the franchise area faced competition, the FCC need not include rates in all systems deemed to be "subject to effective competition." The industry has conceded that there are reasons why cable systems that are not subject to rate regulation under the new statute nevertheless do not reflect competitive rates. The Coalition thus again urges the FCC to eliminate from its determination of competitive rates prices charged by systems with less than 30 percent penetration.[23]

C. The Industry's Analyses Suggest Consumers Are Not Adequately Protected

As the foregoing suggests, the true flow in the existing benchmarks are not that the benchmarks result in rates that are too low, but that the benchmarks do not adequately protect consumers. In light of the industry data that supports the Coalition's contentions that benchmarks may well result in rates higher than they should be, it is critical that (1) franchising authorities and the FCC, as well as operators, should be able to initiate costs of service proceedings to ensure that rates are neither unreasonably high or unfairly low; and (2) for reasons suggested above and in Section III, rate regulation should be based upon and reflective of the cost of providing service.

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[23]The Coalition supports the comments filed in that proceeding by NATOA and the City of Alexandria, Virginia.

III. THE FCC IS NOT REQUIRED TO TREAT BASIC AND OTHER TIERS DIFFERENTLY

Many of the petitions for reconsideration filed by the industry claim that the FCC erred in establishing a "tier neutral" system of regulation. The primary basis for objection are: (1) a tier neutral approach creates incentives to reduce objections go primarily to the point that they will not be able to obtain more money by shifting services to a higher tier.

Another benefit is that a tier neutral approach eases many regulatory burdens. It essentially requires only one calculation by the operator. Likewise, a franchising authority considering whether to file a rate complaint need not perform new calculations. It also facilitates franchising authorities' ability to assist subscribers and the FCC regarding rate complaints. It makes dual cost allocations less likely. In short, a single regulatory method has significant administrative advantages. These arguments are not rebutted by the operators, and based on the Coalition's experience, the Commission's position was correct.

The operators claim that they should be able to subsidize basic rates by augmenting expanded basic rates. It is arguable that Congress indeed intended to allow franchising authorities to set the rate for basic so that basic services recovered marginal costs. Out there is nothing inconsistent with such an approach and a tier-neutral approach that sets a general, per-channel rate for basic and expanded basic. What the industry wants is something more: the right to charge supra-competitive rates for expanded basic, without in any way upsetting these rates by reduction in basic service. Under the circumstances, operator interest in subsidizing basic service rings hollow.[28]

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[28]Notably, there is no indication int he record that operators were subsidizing basic revenues when rates were deregulated.

Lastly, the industry re-raises claims that the language of the Act and its legislative history reveal an intent to regulate non-basic tiers less heavily. As the FCC recognized, however, Congress intended to limit all monopoly abuse; it did not intend (as the industry claims) to circumvent only the worst offenders. FCC Report and Order at ¶¶ 388-389. Congress made no finding that only a small portion of operators were charging excessive non-basic rates. Instead, it gave the FCC broad discretion to curb all abuse in light of the factors listed in the Act, as well as other relevant factors.

The industry's central point appears to be that the FCC was required to consider different factors in developing a regulatory scheme for basic and for expanded basic; ipso facto, the industry argues, the end result must be a different regulatory scheme. The conclusion, of course, does not follow from the premise. The FCC, once it properly weighed and balanced the factors, could reasonably conclude that the same regulatory method would satisfy Congressional goals, particularly since, in both cases, the overriding objective was to protect subscribers from monopoly rates.[29] The FCC's decision was further bolstered by the fact that, while not identical, the factors to be considered in evaluating basic and expanded basic rates are overlapping to a great degree.

[29]Indeed, it is hard to imagine how the FCC could have reached the result the industry seeks consistent with the relevant statutory factors, namely, ensuring that rates reflect costs and that rates reflect prices charged by systems facing competition. 47 U.S.C. § 543(c)(2)(B) and (E).

IV. THE INDUSTRY FILINGS DEMONSTRATE THE NEED FOR A COST-BASED REGULATORY SYSTEM IN THE LONG TERM

The cable industry contends that there are fundamental flaws with the FCC's regulatory scheme. The Coalition agrees that there are substantial flaws that need to be amended, but believe that the "solutions" advocated by the industry aggravate the problems. Instead, the Coalition believes that many of the problems that result from using the FCC's methodology over the longer term can be resolved by adopting a cost-based benchmark system that takes into account industry revenues and costs.

Several industry representatives concur that rate regulation makes little sense absent any reflection of costs of providing service. See CATA petition at 14; Century Communications Corp. petition at 3-4. See also Paul Farhi, Cable Firms to Battle Rate Cuts, The Washington Post, May 6, 1993 at B12, B14, attached as Exhibit I. (Statement by NCTA president Jim Mooney that failure to analyze industry costs and profitability leaves FCC open to huge number of cost of service challenges), attached as Exh. 1. But the industry errs to the extent that it urges the FCC to adopt an approach that does not consider revenues as well as costs. Such an approach would violate the Act. 47 U.S.C. § 543(b)(2)(C)(iv) and (c)(2)(F).

Operators claim, for instance, that there is no rational basis for permitting pass throughs of retransmission fees after October 1994, but not allowing initial retransmission consent costs to be passed through. Time Warner petition at 30. Another claim is that all costs that arise or are expended after

September 30, 1992 should be passed through. Continental petition at 8. The industry also claims that there is no logic incurred.[30] To ensure that operators are rewarded for improving service, while at the same time ensuring that rates do not exceed reasonable levels, rates must ultimately be based on costs paid and revenues received from providing service. With such cost-based rates, new expenditures will be recoverable by operators, but subscribers won't be forced to pay twice for services included as part of the benchmark-derived rate but not provided as part of service when rate regulation begins.

The need for cost-based regulation is also apparent in view of the industry's claim that the FCC's benchmarks provide disincentives to provide new and better programming.[31] The Coalition agrees that undifferentiated per-channel rates benchmark system do create some inappropriate incentives if relied upon over the long term. Again, a cost-based system will alleviate these inverted incentives.

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[30]Even if the benchmarks were set at appropriate levels, they represent a composite reasonable rate, not a particular system's costs of providing service. Thus allowing a cost increase to be passed through might overcompensate in some instances, and refusing to allow a cost to be passed through might undercompensate in other instances.

[31]The Coalition disputes the industry's claims that the per-channel rate increase allowed by the benchmark system is too small to compensate for the value of the additional programming. Continental petition at 5. In addition, it is not apparent that the benchmark system contemplates any rate increase for additional programming channels. It is not clear how <u>any</u> system changes -- large or small -- will be accounted for under the benchmark scheme. Nothing in the FCC's new rules or its Report and Order assures operators that they may increase rates if and when they add channel capacity, other than by passing through programming cost increases that exceed inflation. They should not be allowed to do so: allowing operators to increase costs by the benchmarks for each channel added would encourage operators to game rates to monopoly levels by adding no-cost or home shopping channels.

Other objectives raised by the industry also lend support to the Coalition's view that, in the long run, a cost-based regulatory system is essential. For example, a study by Anthony industry objections to the FCC's tier-neutral structure.

V. OTHER CLAIMS RAISED BY THE INDUSTRY ARE WITHOUT MERIT

A. There is No Need to Exclude Franchise Fees or Taxes from Subscriber Bills

A number of industry petitions object to the FCC's decision that rate quotations must include franchise fees and taxes. TCI petition at 24-26; Continental petition at 17-19. The operators claim that the requirement effectively prohibits cross-community advertising. Continental petition at 17. But that argument makes no sense.

Franchise fees are derived by calculating operator revenues, including but not limited to revenues from subscriber rate payments. If an operator charges $10 for service in two communities, but pays a 3 percent franchise fee in one area and a 5 percent franchise fee in another, the rate charged for service is still $10 in both places, and the operator can advertise it as such. Franchise fee payments are a cost of doing business -- they are essentially rental payments for use of public rights of way. Those costs need no more be reflected separately in rate announcements than, for example, rental payments the operator makes for office space. And presumably those amounts vary as well from community to community.

Moreover, the claims that including amounts for franchise bear no relation to cost, or that costs of providing service vary little from one geographic area to the next, and from one community to the next.[32]

B. Operators Should not be Permitted to Charge Lower Rates to Meet Competition

The industry claims that, despite the uniform rate requirement, it should be permitted to charge lower rates in portions of the franchise area to meet competition. TCI petition at 18-20; Continental petition at 13-15.

Nothing precludes operators from meeting competition as long as they offer the same services to all subscribers at the same rates. The uniform rate requirement is clear, and the underlying rationale for the provision is also clear. Congress did not want operators to be able to eliminate competition by meeting or undercutting prices only in portions of the service area that faced potential competition.[33] Senate Report at 76. The FCC rules are generous in permitting bulk discounts and promotional

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[32]It also supports the contention that the uniform rate requirement should be applied system-wide, and not merely across the franchise area. See Comments of Austin, Texas, et al. in this docket.

[33]Adopting the operators' position will discourage competition. If a community wishes to expand an operator's franchise so it overlaps with a neighboring operator, it may be able to bring the benefits of competition to all subscribers in an area, not just those in the overlap region, so long as the uniform rate provision is strictly applied. If it is not strictly applied, the effect of creating overlapping franchising may be to (1) limit competition to a relatively small area while (2) deregulating rates for subscribers that do not have competitive alternatives. Several communities face this problem.

rates as long as a cost savings can be shown (and will be passed on to the subscriber).

The industry also claims that it should be able to comply with the terms of preexisting contracts with Multi-Dwelling Units ("MDUs"). TCI petition at 20-21; Continental petition at 14. Except for contracts that specify that rates charged to MDUs will be lower than rates generally available to the public, nothing in the FCC's rules require operators to breach those contracts. And even those contracts are sustainable under FCC rules if they can be justified by costs.[34] Thus, contracts that specify service to MDUs at a particular rate (or level of increase) need not be breached. However, the operator must make those reduced rates available to all subscribers.

Absent such a showing, there is no reason to allow operators to charge lower rates to some MDUs but not all of the community. It it is not cost-justified that rate may well reflect competitive rate levels, and no subscriber should be forced to pay more than that level for service. Further, because of the FCC's regulatory system, and particularly the fact that only operators can initiate cost of service showings, there is no way to ensure that the lower rates provided by MDUs are not being subsidized by rates charged to the general public.

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[34]Reduced rates not justified by cost were prohibited under the 1984 Cable Act, Section 623(f).

C. <u>The FCC's Refund Provisions Are Lawful and Appropriate</u>

The industry asserts that the FCC was not authorized to establish rules that permit refunds of basic service rates. Allegedly, because the 1992 Act expressly authorizes refunds for non-basic services, other refunds were implicitly precluded. Time Warner petition at 25. In fact, however, the FCC rules authorize fewer refunds than Congress intended. Congress intended rate regulation to be effective as of April 3, 1993. But initially, refunds for basic service only went back to June 21. And now, refunds will apparently date back only to September 1. The FCC is not ordering rate reductions to date back earlier than was contemplated by Congress.

Nothing in the Act precludes refunds for basic service. The refund provision in the legislation with respect to non-basic services was mandated by the fact that (as opposed to basic service rates) the operator can charge initial rates and rate increases until a complaint is filed. Thus, Congress wanted to

Time Warner claims that the FCC should limit the date back to which non-basic rate refunds may be issued. Time Warner petition at 27. The operators proposed to limit refunds for initial rates back to one year, and to limit refunds for subsequent increases to six months. Id. Both operators and the public will benefit from these time limitations, Time Warner argues. But the public would not be benefitted -- and in fact would be significantly injured -- if the FCC does not issue a rate decision within the proposed time period. Imposing time limitations within which the FCC must decide rate complaints creates additional and unnecessary pressure on an agency already overwhelmed by administrative tasks. There is no reason to reward operators and punish subscribers because of the FCC's workload. Nor is it clear that operators do not actually benefit from the delays. They are able to use and invest funds to which they may not be entitled until the FCC issues its rate decision. At a minimum, it is not clear that the uncertainty about which Time Warner complains is not more than offset by its ability to utilize the funds for its own benefit until the FCC orders a portion of the subscriber fees to be refunded. ("Kern study")

Respectfully submitted,

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INDEX TO EXHIBITS

EXHIBIT A

FINANCE

MSOs Facing $2B Hit From New FASB Rule

By JOHN M. HIGGINS

Investors could be a bit rattled in the coming weeks because a new accounting rule is forcing cable operators to write down more than $2 billion worth of their reported equity.

The good news is that the write-downs will not truly affect MSOs' financial condition. The adjustments involve a new rule requiring immediate acknowledgment of the companies' potential tax liabilities, a non-cash item that will not actually require any unexpected payments. That will affect measures like net income and book value, but not cash flow and private market value, the traditional benchmarks for cable operators.

The bad news is that headlines like "Comcast Takes $1 Billion Charge" could jar stock and bond traders and private investors. "It's largely an accounting issue," said Chris Dixon, an analyst at PaineWebber who has been studying the issue for weeks. "At the same time as cable continues to look at new investors, those who look at things like book value and net income, it could hurt."

'ACCOUNTING GYMNASTICS'

Comcast Corp. treasurer John Alchin called the change "accounting gymnastics" and emphasized that it doesn't actually force the MSO to write any unexpected checks. "It changes absolutely nothing about the company, how much it's taxed or when it would have to pay taxes," he said.

But the numbers will be huge. Comcast has warned investors that it could recognize a new $1.1 billion tax liability.

Tele-Communications Inc. is expected to restate several years' worth of past financial statements totaling $1 billion. Continental Cablevision Inc. has already taken a $149 million charge.

Some MSOs will benefit from the rule change. The Washington Post Co. and Times Mirror Corp. actually posted small increases in tax benefits, not liabilities. Washington Post CFO Jay Morse said his company, which owns Post-Newsweek Cable, incurred deferred liabilities when tax rates were much higher, up to 46 percent. Now that corporations pay taxes at 34 percent, Washington Post reversed much of its liabilities at a "profit."

Other companies may not have any liabilities to recognize because years of accounting "losses" have built up a big enough shelter to cover the deferred tax liability.

Cablevision Systems Corp. said it falls into this category. "We have $600 million in net operating losses" that carry forward, said Cablevision controller Jerry Shaw.

Other MSOs, including Time Warner Inc. and Adelphia Communications Corp., said only that adjustments won't be "material".

The change is rooted in the arcane swamp of regulations set by Financial Accounting Standards Board, a private group that drafts guidelines aimed at fully informing investors about a company's earnings and financial condition.

THE NEW RULE: SFAS 109

The new tax rule — known as Statement of Financial Accounting Standard (SFAS) 109 — hinges on the fact that all companies keep two sets of books, one based on tax accounting standards, the other on a formal set of generally accepted accounting principles, or GAAP. As a result, a company may report a "loss" by GAAP accounting, yet still report a profit on a tax basis and face a federal income levy.

Generally, the liabilities stem from MSOs' acquisition activity plus heavy depreciation over several years.

> "You continue to have the same obligations; you just report them differently."
>
> *John Alchin, treasurer, Comcast Corp.*

Companies depreciate a portion of their assets each year because equipment loses a portion of its useful life. Depreciation not only paints a more accurate picture of the company's assets, but also reduces taxable income.

Because cable systems are so asset intensive, heavy depreciation has left MSOs "losing money" for years even though they have plenty of cash to sustain operations.

However, companies must pay the tax man if they sell their assets. A seller must pay a tax on the "capital gain" — the difference between the seller's cost and the price of the deal.

But depreciation and amortization reduces that cost basis each year.

So a package of cable systems selling for tens of millions of dollars may have a cost basis near zero when it comes to calculating the taxable gain.

The next step depends on how the systems are sold. Sales are often straight asset deals where an MSO acquires only the system. Liabilities and any taxes are left to the seller. So a buyer paying $100 million records that figure as the cost for both GAAP and tax books.

That's great for the buyer because he gets to start the depreciation cycle from $100 million and count down, shielding income from taxes along the way. But the seller faces a big tax bill on his capital gain.

So a seller may prefer to sell not just the system assets, but the entire company. The seller's taxes go down, but a stock sale also reduces the sale price. The buyer can't write the assets up on its tax books and start the depreciation cycle at $100 million.

The key is the way the company records the deal; it writes the assets up to full value then begins depreciation.

The tax books may be carrying the systems at $25 million, while the GAAP books have it at $100 million.

The tax on the difference between the two figures hasn't disappeared; it's simply been deferred until another day.

"Thirty four percent of that difference is what you take as your tax liability," said one MSO finance executive. If the buyer ever resells the individual systems, that deferred tax liability will pop up and take a big chunk out of the proceeds.

The deferred tax liabilities of TCI and Comcast are so high because the companies have done a number of stock acquisitions over the years. The recent break-up of SCI Holdings and Storer Cable put about $500 million worth of liabilities on Comcast's books. Another big chunk stems from the MSO's acquisition of the MetroPhone cellular operation.

Sources familiar with TCI's position said the MSO incurred a liability of similar size, plus several hundred million dollars more from other acquisitions.

Despite the big numbers, Alchin said the new rule is just another headache that occurs whenever accounting rules change. "Life continues the same," he said. "You continue to have the same obligations; you just report them differently."■

EXHIBIT B

3-22-93
CABLE WORLD

Profits To Become Benchmark at TCI

By K.C. Neel

Tele-Communications Inc., which has posted earnings for the last two quarters, expects to keep reporting profits — something new for the nation's largest MSO, which has traditionally reported losses and concentrated on its cash flow as a barometer of success.

Indeed, after TCI reported its first reported quarterly profit, president John Malone said it was unlikely that trend would continue because TCI didn't want to pay taxes on profits.

But Gary Howard, TCI's vice president of corporate development, told investors during Hanifen, Imhoff Inc.'s March 12 institutional investor conference that profits will continue to roll in at TCI in the foreseeable future.

"We expect earnings going forward," he said.

TCI reported a $17-million profit in its third quarter ended Sept. 30 vs. a loss of $77 million for the same year-before period. The company's year-end results are scheduled to be released later this month.

TCI's Class A stock closed March 17 at $23.88 a share, down 62.5 cents.

Digital compression

Howard said free cash flow should continue to grow, predicting that it could reach $500 million by year's end. TCI plans to spend about $300 million a year over the next three years to deploy digital compression in all its systems. The free cash flow will be used to pay for that project, he said.

TCI expects to stay at about the 5.5 times debt-to-cash flow level, Howard said.

"This is an optimal level for us," he said, noting that 58 percent of TCI's $9.2 billion in debt is fixed. The company has a 277-percent interest coverage ratio.

EXHIBIT C

APPLICATION FOR APPROVAL OF TRANSFER OF

MONTGOMERY COUNTY, MARYLAND

CABLE TELEVISION FRANCHISE TO

SBC MEDIA VENTURES, INC.

Pro Forma

Funds Flow Statement Montgomery

SOURCES & USES OF CASH	7/31/93*	1993**	1994	1995	1996	1997	1998	1999	2000	2001	2002
Beginning Cash	0	0	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Sources:											
Net Income		(2,776)	(2,365)	1,525	6,077	10,546	15,473	20,902	27,160	32,593	38,024
Depreciation		6,053	15,809	17,058	18,366	19,740	21,177	22,670	24,270	25,954	27,715
Amortization of Intangibles		5,796	13,910	13,910	13,910	13,910	13,910	13,910	13,910	13,910	13,910
Amortization of Goodwill		1,339	3,214	3,214	3,214	3,214	3,214	3,214	3,214	3,214	3,214
Increase in Deferred Taxes		(1,967)	1,008	7,442	3,877	1,230	(760)	(748)	(723)	(4,455)	(6,315)
Increase in Debt	344,000	(23,655)	(20,071)	(32,154)	(33,752)	(36,403)	(39,988)	(46,519)	(26,729)	(24,183)	(23,524)
Equity	190,000	0	0	0	0	0	0	0	0	0	0
Increase in Accounts Payable		12,111	890	1,073	971	1,072	923	1,028	1,481	1,753	1,925
Increase in Other Current Liab.		10,934	1,075	1,121	1,091	1,114	1,112	1,222	1,522	1,683	1,790
Total Sources of Funds	534,000	7,835	13,468	13,189	13,754	14,422	15,061	15,679	44,106	50,469	56,739
Uses:											
Capital Expenditures		4,938	12,804	12,498	13,080	13,734	14,375	14,925	16,006	16,837	17,610
Increase in Accounts Receivable		586	433	452	440	449	449	493	614	679	722
Increase in Other Current Assets		245	181	189	184	188	188	206	257	284	302
Increase in Other Assets		66	49	51	49	50	50	55	69	76	81
System Purchase	534,000										
Common Dividends		0	0	0	0	0	0	0	27,160	32,593	38,024
Total Uses of Funds	534,000	5,835	13,468	13,189	13,754	14,422	15,061	15,679	44,106	50,469	56,739
Ending Cash	0	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000

DEBT REPAYMENT SCHEDULE	*7/31/93**	*1993***	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*
Beginning Debt	344,000	344,000	320,345	300,273	268,120	234,368	197,964	157,976	111,457	84,727	60,544
Principle Repayment		23,655	20,071	32,154	33,752	36,403	39,988	46,519	26,729	24,183	23,524
Ending Debt	344,000	320,345	300,273	268,120	234,368	197,964	157,976	111,457	84,727	60,544	37,020

INTEREST EXP. SCHEDULE	*1993***	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*
Interest Expense***	11,825	26,428	24,773	22,120	19,335	16,332	13,033	9,195	6,990	4,995

* At time of Closing

** Partial Year reflects SBC–MV ownership period between 7/31/93 and 12/31/93.

*** Interest Expense is based upon previous year–end debt @ 8.25%.

MONTGOMERY CABLEVISION LIMITED PARTNERSHIP
STATEMENT OF SOURCES AND APPLICATIONS OF FUNDS
FOR YEAR ENDING DECEMBER 31, 1992

SOURCES :

NET LOSS	(22,222,705)
CHARGES NOT REQUIRING THE USE OF	

BUSINESS

96

Southwestern Bell to Buy Arlington, Montgomery Cable

By Paul Farhi and Cindy Skrzycki
Washington Post Staff Writers

In a transaction that further blurs the line between the telephone and cable TV industries, phone giant Southwestern Bell Corp. said yesterday that it will buy the cable TV franchises serving 225,000 households in Montgomery and Arlington counties for $650 million.

Southwestern's purchase of the systems from Hauser Communications Inc. would mark the first time a so-called Baby Bell phone company has owned a cable franchise, and could alter the debate surrounding federal telecommunications policy.

St. Louis-based Southwestern Bell, which had $10 billion in revenue last year, already does business in the Washington area through its ownership of the cellular phone franchise Cellular One, and publication of a local phone book, the One Book.

Cable TV Montgomery serves 172,000 households and Arlington Cable has 53,000 subscribers, making the combined systems the 12th-largest in the nation. The sale should be completed by midsummer, Southwestern Bell said.

Southwestern Bell's plans are not without some irony. Telephone companies have campaigned for a decade for permission to enter the cable business within their own service areas, charging that cable companies are "unregulated monopolies" that make excessive profits. Southwestern Bell and the six other regional phone companies are still barred from owning cable systems in their own back yards, but Southwestern Bell now will become a member of the industry it has criticized.

Southwestern Bell's proposed purchase could allow it to be both a cable company and a phone company simultaneously. Using existing cable wires in the two counties, Southwestern Bell would be able to launch the next generation of cellular telephone service, called "personal communications service" (PCS), observers said yesterday.

PCS is a less-expensive version of cellular technology that permits calls to be made from pocket-sized phones. Several cable companies are attempting to adapt their cable systems so that they can also serve as the backbones for PCS systems.

If it does enter the PCS business through the Montgomery and Arlington cable franchises, Southwestern Bell would compete directly with the local phone company, Bell Atlantic Corp., in providing local phone service. Bell Atlantic, meanwhile, is testing an experimental TV system in Arlington using its phone network—which would put it in direct competition with Southwestern Bell.

Bell Atlantic also is challenging the federal law that prohibits it and other Baby Bells from owning cable systems inside their service areas—so that it may eventually compete with Southwest-

See CABLE, C3, Col. 4

[illegible]